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CHARLES ELMORE CROPLEY
CLERK

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1952

No. 319

ROBERTS DAIRY COMPANY,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT AND BRIEF IN SUPPORT THEREOF.

JOSEPH J. O'CONNELL, JR.,
Counsel for the Petitioner.

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To the Honorable Chief Justice and Associate Justices of the Supreme Court of the United States:

The Petitioner, Roberts Dairy Company, prays that a writ of certiorari be issued to review the decision of the United States Court of Appeals for the Eighth Circuit in the above case.

Opinions Below

The opinion of the Tax Court of the United States (R. 28-35),* is reported in Par. 50,271 P-H T.C. Memo. The opinion of the United States Court of Appeals for the Eighth Circuit (R. 106-111) is reported in 195 F. (2d) 248.

Jurisdiction

The judgment of the United States Court of Appeals was entered on April 15, 1952 (R. 111-112). The Petitioner's

* "R" designates references to portions of the printed record.

motion for a rehearing was denied on May 7, 1952 (R. 121). Petitioner's motion for an extension of time in which to file this petition up to and including September 8, 1952 was granted by Mr. Justice Clark by an order dated July 22, 1952.

Questions Presented

During the taxable year the Petitioner was engaged in the dairy business in the states of Nebraska, Iowa, and South Dakota. In October, 1943, it paid $750 to the National Tax Equality Association (hereinafter called "NTEA") a non-profit organization, to obtain assistance in meeting the competition of cooperative daries. The questions presented are:

1. Whether the amount paid to NTEA was deductible under Section 23(a)(1)(A) of the Internal Revenue Code as ordinary and necessary expenses of dairy business.

2. Whether the courts below erred in holding that this amount was not deductible under Section 23(a)(1)(A) because of the Tax Court's finding that NTEA's objectives were the carrying on of propaganda or of otherwise attempting to influence legislation.

Statutes Involved

The statutes involved are Sections 23(a) (1) and 23(q)(2) of the Internal Revenue Code.

"Sec. 23. Deductions From Gross Income.

"In computing net income there shall be allowed as deductions:

"(a) Expenses.—

"(1) Trade or business expenses.—

"(A) In general.—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business * * *.

"(B) Corporate charitable contributions.—No deduction shall be allowable under subparagraph (A) to a corporation for any contribution or gift which would be allowable as a deduction under subsection (q) were it not for the 5 per centum limitation therein contained * * *.

"(q) Charitable and Other Contributions by Corporations.—In the case of a corporation, contributions or gifts payment of which is made within the taxable year to or for the use of:

* * *

"(2) A corporation * * * organized and operated exclusively for * * * scientific * * * or educational purposes * * * no part of the net earnings of which inures to the benefit of any private shareholder or individual, and no substantial part of the activities of which is carrying on propaganda, or otherwise attempting to influence legislation. * * *"

Statement of Facts

The petitioner is a corporation organized under the laws of the State of Nebraska engaged in the business of wholesaling and distributing dairy products. It conducted its business as a so-called "independent", i.e., not producing its own milk but buying it from farmers and processing it for sale (R. 29).

In the years immediately prior to and including 1943, the Petitioner was faced with severe competition from dairies functioning in a cooperative type of business organization. The Petitioner had difficulty retaining both its suppliers and customers because of the advantages offered them by the cooperatives. These advantages were made possible because of the stronger financial position of the cooperatives brought about to a large degree by their tax exempt status under Sections 101(2) and (13) of the Internal Revenue Code (R. 29, 78-81).

The Petitioner was faced with the alternatives of reorganizing itself along cooperative lines or adopting other means of meeting the cooperative competition. It needed detailed information on the operations and activities of the cooperatives to make this decision and to determine the best way of meeting cooperative competition (R. 29, 82-82).

In 1943 the Petitioner contributed $750.00 to the NTEA for the purpose of getting information, particularly about competitive cooperatives in its territory who were directly competing with Petitioner in the marketing of the by-products of the dairy business. The NTEA's program included supplying its members with information bearing on the extent and cause of the competitive advantages enjoyed by the cooperative organizations (R. 29-30, 38).

The Petitioner did not make its contribution with any intention of having it used for the urging of revision in federal or state income tax statutes. The NTEA made no such representation. That was not the understanding between the parties (R. 83, 84, 86).

The Petitioner actually used the information furnished to it by the NTEA to give its customers and suppliers the facts about the cooperatives, the source of the competitive advantages and thereby attempt to retain their patronage and good will (R. 83-85).

The NTEA was incorporated on October 11, 1943, under the laws of the State of Illinois as a non-profit organization. Its incorporation was procured by a group of businessmen (not including any officer of the Petitioner) to conduct educational, scientific and research activities relative to disparities in federal and state tax statutes and to disseminate such information to civic organizations. During 1943 the NTEA did not engage in lobbying, was not interested in any pending legislation and its activities were confined to the conducting of research activities and the dissemination of

the results to their members and to the public. In later years it appeared before Congressional Committees and gave publicity to matters affecting tax equality legislation. The Tax Court found that the NTEA was organized and operated from its inception for the carrying on of propaganda with the ultimate objective being a change in the tax structure (R. 30, 31, 37, 41, 86, 88-96).

On January 10, 1944, the Commissioner of Internal Revenue ruled that the NTEA was exempt from federal income tax under section 101(7) of the Internal Revenue Code as a business league (R. 31, 66-67).

Specification of Errors to Be Urged

The Court of Appeals for the Eighth Circuit erred:

1. In holding that the amount paid to NTEA was not deductible under Section 23(a)(1)(A) of the Internal Revenue Code as ordinary and necessary expenses of the dairy business.

2. In holding that this amount was not deductible under Section 23(a)(1)(A) because of the Tax Court's finding that NTEA's objectives were the carrying on of propaganda or of otherwise attempting to influence legislation.

3. In affirming the decision of the Tax Court.

Reasons for Granting the Writ

I. The Decision of the Court of Appeals Is Based on a Misreading of the Decision of This Court in Textile Mills Securities Corp. v. Commissioner and Is Necessarily in Conflict Therewith.

Under Section 23(a)(1)(A) a taxpayer may deduct all "the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business." Neither the Court of Appeals nor the Tax Court

found that the contribution to the NTEA was not an ordinary or a necessary expense incurred in carrying on the petitioner's business but these Courts nevertheless disallowed the deduction on the ground that the NTEA was engaged in lobbying activities.

The petitioner's position can be simply stated. The Courts below have found on the evidence that the NTEA was engaged in a form of lobbying activity and for the purposes of this proceeding your petitioner does not challenge that finding. No similar finding was made as to the petitioner's activities. Petitioner contends that the deductibility of the payment in question as an ordinary and necessary business expense, must be decided on the basis of the purposes and objectives of the taxpayer claiming the deduction and it is an error, as a matter of law, to decide the question on the basis of the activities or purposes of the donee of the contribution in the absence of a finding that would impute such purposes to the taxpayer. And this taxpayer—the petitioner—did not make any payments for lobbying purposes nor engage in any lobbying activities, nor did it intend or expect that its contribution would be so used. In what appears to be a total misconstruction of this court's opinion in *Textile Mills Securities Corp.* v. *Com'r.*, 314 U. S. 326 the Courts below have failed to accord any weight to these crucial facts.

The petitioner relies on Section 23(a)(1)(A) of the Internal Revenue Code as the principal basis of its claim. *The Courts below did not even pass on the deductibility of the payment under this section.* It is plain from their opinions that they considered the claim as being made solely under Section 23(q)(2) and did not separately consider petitioner's contention under Section 23(a)(1)(A). In fact, it appears to be their impression that having decided that the payment was not deductible under Section 23(q)(2) it

automatically follows that it was not deductible under Section 23(a).

The fallacy of this position is only too obvious. While the two sections have a slight area of overlap they were designed to prescribe conditions of deductibility of two widely differing types of expenditures. That a contribution is not deductible under Section 23(q)(2) has no bearing on its deductibility under Section 23(a)(1)(A); it need not meet the requirements of both sections.

A contribution is deductible under Section 23(q)(2) if the organization to which the contribution is made is organized and operated exclusively for religious, charitable, scientific, or similar purposes, and if a "substantial part of the activities" of that organization do not consist of "carrying on propaganda or otherwise attempting to influence legislation." The NTEA was ruled exempt from tax as a business league and by its own admission was not organized or operated exclusively for the purposes specified in Section 23(q)(2).

A payment is deductible under Section 23(a)(1)(A) if it is an ordinary and necessary expense of the business of *the taxpayer claiming the deduction.* Conceding, *arguendo,* that sums spent for lobbying purposes are not "ordinary and necessary" expenses of a business, it is the plain meaning of Section 23(a)(1)(A) that "ordinary and necessary" be tested in the light of the taxpayer who has made the donation. That the donee here, an independent entity, used the donation for purposes not ordinary and necessary to *its* business is entirely outside the issues of this case. The doctrine of "guilt by association" has no place in the tax law. Where subjective intent is an operative fact the courts have refused to attribute the purpose of one taxable entity to another even where the relationship of parent and subsidiary exists between them. See *Mead* v. *Com'r.,* 116 F. 2d 187 (C.C.A. 3, 1940); *Rodman Wanamaker Trust,* 11 T.C.

365 (1948), affirmed 178 F. 2d 10 (C.C.A. 3, 1949). The purposes of the donee organization are only material if there is evidence attributing such purposes to the taxpayer and there was none in this case.

It is apparent that neither the Tax Court nor the Court of Appeals appreciated this distinction. The Tax Court stated—

> "This being the case we can only conclude that the objectives of its [NTEA's] activities were the carrying on of propaganda or otherwise attempting to influence legislation under section 23(q)(2) and the promotion or defeat of legislation or the exploitation of propaganda within the prohibition of section 29.23(q)-1 of Regulations 111. *Therefore,* the expenditure here in question is non deductible under either section 23(q)(2) or 23(a)(1)(A)." (Italics supplied.)

The opinion of the Court of Appeals literally ignores Section 23(a)(1)(A). Its entire opinion is a discussion of the NTEA, its charter and its activities. The opinion concludes as follows:

> "Clearly the Tax Court did not err in holding that the contribution here involved was not deductible within the meaning of § 23(q)(2) of the Internal Revenue Code and § 29.23(q)-1 of Treasury Regulation 111."

From these quotations it is apparent that neither of the Courts below attached any importance to the preponderance of credible evidence that the petitioner did not expend the sum in question for lobbying purposes. As neither Court made any finding of fact as to the Petitioner's purposes it is apparent that they failed to recognize that such purposes were the real issue in the case. It is submitted that your Petitioner is entitled to have its claim under Section 23(a)(1)(A) passed upon and neither of the Courts below have properly done so. The case was decided solely on the basis

of Section 23(q)(2), a section designed to provide for the deduction of contributions to organizations exempt from tax under Section 101(6).[1] As the NTEA was ruled exempt from tax under Section 101(7),[2] Section 23(q)(2) is inapplicable and it was clearly unnecessary for the Courts even to consider if a substantial part of the NTEA's activities were the carrying on of propaganda or otherwise attempting to influence legislation. The crucial question in this case is whether the *petitioner* made this payment for lobbying purposes. Neither of the lower Courts considered the case in this light although urged to do so by the petitioner.

It is believed the action of the Courts below stems from a misreading of the decision of this Court in the *Textile Mills Case*. Under a specific regulation[3] disallowing the deduction of "sums expended for lobbying purposes" this Court there held that the taxpayer could not deduct sums of money expended for lobbying purposes. But the taxpayer in that case was in the "lobbying business" and the purposes for which it expended the sum in question were clearly within the prescription of the regulation. The Petitioner in the instant case did not contribute to the NTEA for lobbying purposes and there is not the slightest shred of evidence which would support imputing to the Petitioner the purposes of the NTEA. In relying on the *Textile Mills* case without noting this crucial distinguishing fact, the Tax Court is giving that case an interpretation never intended by this Court.

The Tax Court's misconception on this point is clearly revealed in its opinion. It stated:

> "The Supreme Court in *Textile Mills Securities Corp. v. Commissioner*, 314 U. S. 326, has unequivocally

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[1] See Appendix.

[2] See Appendix.

[3] Regulation 74 Article 262 (See Appendix); That regulation has been substantially revised since the taxable years involved in the *Textile Mills* case and the effect of that revision is discussed in Section II, *infra*.

applied that portion of article 23(q)-1 of Regulations 94, which in all material respects is the same as section 29.23(q)-1 of Regulation 111, here applicable, to make non-deductible under section 23(a)(1)(A) expenditures to an organization engaged in the activities set out in the regulation."

The Supreme Court could hardly have "unequivocally applied" section 29.23(q)-1 of the Regulations to contributions to a lobbying organization in the *Textile Mills* case when that case did not involve contributions at all. That case involved the deductibility of actual expenses under a regulation making non-deductible "sums expended for lobbying purposes" which by its terms was applicable to Section 23(a) and this Court upheld the validity of the regulation. But as the Tax Court did not find that the petitioner here expended the sums in question for lobbying purposes the *Textile Mills* decision provides no authority for the decision of the Courts below. The petitioner is confident that the record supports its position that this contribution was not made for lobbying purposes. It had no interest in obtaining the lobbying services of the NTEA, was not aware of them and it had several bona fide business reasons for contributing to the NTEA other than to obtain tax legislation. It is equally clear that the petitioner did not use any of the information or data or statistics received from the NTEA for lobbying or propaganda purposes.

If there were evidence that the petitioner knew of the NTEA's plans or concurred in them, it would certainly have been relevant and yet the *respondent presented no such evidence nor do the Courts below so find.* The testimony of W. J. Kirkbride, Vice-President of the Petitioner, clearly shows that the Petitioner had no such knowledge. On cross-examination, he testified as follows:

"It was not our Company's understanding at the time it made this contribution in 1943, that NTEA

> would work towards the elimination of the exemption, contained in the federal revenue laws, from taxation of cooperatives; not to my knowledge. * * * Mr. Roberts discussed things pretty thoroughly with me and it was never brought up that it was a possibility that the NTEA would work towards the removal from federal tax laws the exemption of cooperatives. I would say that in 1943 in reading the bulletins issued by NTEA and other information they have sent us, there was nothing to indicate NTEA was endeavoring to have the tax exemption on cooperatives repealed or modified; * * *." (R. 86)

The Tax Court's findings do not question the credibility of this testimony. That Court strained to find that during 1943 even the NTEA was engaged in lobbying activities—and explicitly based its decision partially on events occurring after December 31, 1943. Indeed, the absence of substantial lobbying activity during 1943 adds weight to the Petitioner's contention that its contribution during 1943 was not made for that purpose.

As the record clearly shows, the Petitioner could readily see the growth of its cooperative dairy competitors. It was not certain of the reason for this growth and was not certain whether its customers and the public in its territory knew the reasons. Petitioner had no research staff and had no way of keeping abreast of the plans of the cooperatives. If the cooperatives enjoyed tax-exempt privileges which Petitioner did not enjoy, then it wanted to know about those privileges, and wanted its customers and the public in its territory to know about those privileges. Petitioner wanted facts and statistics on any tax-exempt privileges enjoyed by its cooperative competitors which could be used in appealing to the sense of fair play of its customers and suppliers.

After the organization of the NTEA in October, 1943, the taxpayer contributed $750.00 to that Association because

it needed the research and publicity work of NTEA to help it meet cooperative competition. It felt that this contribution was necessary for its own welfare. In 1943 and 1944 Petitioner used the bulletins and statistics supplied by NTEA to keep its customers and maintain its profits. It received a detailed study of a dairy which had been struggling as a private enterprise and grew by leaps and bounds as a cooperative. It obtained factual data from NTEA on the tax-exempt privileges enjoyed by its cooperative competitors. It obtained a comprehensive and detailed analysis of the growth of cooperatives in the dairy industry, and the tax privileges enjoyed by these cooperatives over the Petitioner (Petitioner's Exhibit 6).

In short, to maintain its business the petitioner felt it necessary to get the facts about the cooperative movement and to marshal the arguments which would stem the alarming drift of its customers and its suppliers into the cooperative fold. The NTEA supplied this need and the Courts below so found.

The conclusion is therefore inescapable, that the Courts below did not appreciate the sharp distinction that exists between Section 23(a) and 23(q)—for if they had, this record would have required them to find that the contribution in question was deductible as an ordinary and necessary business expense made for purposes other than lobbying and propaganda.

In effect, what the Courts below have done is to place the wrong entity on trial. Under Section 23(a)(1)(A), the petitioner has the right to have its claim for a deduction decided on its own actions and purposes rather than the actions and purposes of a group over which it had no control. The petitioner and the NTEA are two separate entities for all purposes.

The decision of this Court in *Textile Mills* has been invoked in a situation it was never intended to cover. The

decision of the Court of Appeals in affirming the Tax Court is a misconstruction of that decision and is necessarily in conflict with it.

II. The Proper Disposition of This Case Involves an Important Question of Law Which Should Be Settled by This Court.

This case raises an important question with respect to the effect on the *Textile Mills* decision of the subsequent changes in the applicable laws and regulations and the recent decision of this Court in *Lilly* v. *Commissioner*, 343 U. S. 90 (1952).

There can be no doubt that the contribution here in question was an ordinary and necessary expense of the petitioner's business. It is equally clear that it was made for valid and honorable purposes which did not frustrate any sharply defined national or state policy. Assuming, without conceding, that the contribution was made for lobbying purposes, its deduction can only be disallowed on the basis of a specific statute or valid Treasury regulation. Indeed, the result in the *Textile Mills* case was reached solely on the basis of a Treasury regulation. This was explicitly stated in this Court's opinion in *Lilly* v. *Commissioner, supra,* as follows:

> "In *Textile Mills Corp. v. Commissioner*, 314 U. S. 326, this Court accepted an interpretation of that section [Section 23(a)(1)(A)] by a Treasury Regulation which disallowed the deduction of certain expenditures for lobbying purposes."

The *Lilly* case, which allowed the deduction of expenditures incurred in activities recognized by this Court as reprehensible, distinguished the *Textile Mills* case on the ground that no specific regulation was involved.

However, the Treasury regulation relied on in the *Tex-*

tile Mills case has been substantially revised since the taxable years involved in that case in accordance with a change in the underlying statutory structure. Your Petitioner believes that these changes merit a re-examination of the *Textile Mills* case. Without the support of a specific statute or regulation there is no authority for disallowing the deduction of *any* ordinary and necessary business expense except where some sharply defined national or state policy may be frustrated thereby. *Lilly* v. *Commissioner, supra.*

Textile Mills was decided under Article 262 of Treasury Regulation 74, reprinted in the Appendix. This single regulation covered *both* corporate donations under Section 23(n) and donations for purposes connected with the donor's business, deductible under Section 23(a). Relying on the last sentence of the regulation ("sums of money expended for lobbying purposes * * * are not deductible from gross income") this Court denied the taxpayer a deduction in the *Textile Mills* case. With respect to the taxable years involved in that decision, 1929 and 1930, there was no statutory provision permitting a corporation a deduction for contributions or gifts for purely charitable purposes.

Subsequently an important change in the statutes necessitated a revision of the regulations. In Section 102(c) of the Revenue Act of 1935, now Section 23(q)(2), it was provided for the first time that corporations as well as individuals could deduct contributions made to organizations organized exclusively for charitable, scientific, educational or similar purposes, with the exception of such organizations, a substantial portion of whose activities consisted of carrying on propaganda or attempting to influence legislation.

In the Revenue Act of 1938, Section 23(a) was amended to include a new Section 23(a)(2), (now Section 23(a)(1)(B)):

"(2) CORPORATE CHARITABLE CONTRIBUTIONS. No deduction shall be allowable under paragraph (1) to a corporation for any contribution or gift which would be allowable as a deduction under subsection (q) were it not for the 5 per centum limitation therein contained * * *."

In the report of a Subcommittee of the House Ways and Means Committee this new provision was explained as follows:

"In 1935 the income-tax law was amended to provide a specific deduction for charitable and other contributions by corporations to an amount not exceeding 5 percent of the corporate net income. No similar provision appeared in the law in prior years; but with respect to such years the Board of Tax Appeals and Federal courts held, in various cases, that particular gifts to charitable, religious, and welfare organizations were deductible as business expenses. When the specific subdivision was inserted in 1935, no change was made in the subdivision allowing deductions for business expenses, probably because the *Congress believed that the new specific provision would necessarily be controlling in respect of contributions to the designated organizations.* In order to clarify the law, the subcommittee recommends (Recommendation No. 36) that the specific subsection relating to business expenses, section 23(a), be amended to provide expressly that no deduction shall be allowed to corporations thereunder for any contribution of a class with respect to which a deduction is allowed by section 23(q)." (75th Cong., 3d Sess., H. Rept. January 14, 1938; p. 48; italics added.)

The report makes it plain that Section 23(q)(2) was intended to be controlling in respect of contributions to the type of organization listed in that section. Contributions to other organizations as ordinary and necessary business expenses are controlled by Section 23(a). As

no lobbying limitation was written into the latter section it would appear that Congress did not intend that limitation to apply to organizations not described in Section 23(q)(2). As previously stated the NTEA does not qualify under that section.

This distinction between Section 23(a) and Section 23(q) has been reflected in revised regulations for the taxable year involved in this case. The language of Regulation 74, Article 262 has been split between Regulation 111, Section 29.23(a)-13 and Regulation 111, Section 29.23(q)-1 (reproduced in part in the Appendix). The effect of this split can be readily observed. Section 29.32(a)-13 reads in part as follows (italics indicates identical language as in Regulation 74, Article 262):

> "Donations to organizations other than those described in section 23(q) which bear a direct relationship to the corporation's business and are made with a reasonable expectation of a financial return commensurate with the amount of the donation may constitute allowable deductions as business expenses. *For example, a street railway corporation may donate a sum of money to an organization* (of a class not referred to in section 23(q)) *intending to hold a convention in the city in which it operates, with a reasonable expectation that the holding of such convention will augment its income through a greater number of people using its cars.*"

Regulation 111, Section 19.23(q)-1 reads in part as follows:

> "A corporation may, subject to the limitation provided by Section 23(q), deduct from its gross income, contributions or gifts to organizations described in section 23(q). * * * Such deduction shall, to the extent provided by that section, be allowed only for the taxable year in which such contributions or gifts are actually paid, * * *. As to charitable contributions by corporations not deductible under section 23(a), see

section 29.23(a)-13. *Sums of money expended for lobbying purposes, the promotion or defeat of legislation, the exploitation of propaganda, including advertising other than trade advertising, and contributions for campaign expenses are not deductible from gross income.*"

Thus, instead of a single section covering the entire field of corporate donations disallowing all donations made for lobbying purposes, the current regulations provide for two separate and mutually exclusive sections—only one of which prohibits the deduction of lobbying expenses.

It seems perfectly clear that this "split" in the regulation drew a new distinction between donations made as an ordinary and necessary expense of the taxpayer's business and donations made to organizations described in Section 23(q). As to the latter the prior rule remains in full force and effect—a contribution to an organization engaged in lobbying can not be deducted. But where the payment is an expense of doing business and is not made to an organization described in Section 23(q), *there is no applicable Treasury regulation disallowing the deduction of such an expenditure merely on the grounds that it was expended for lobbying purposes.*

Therefore, as the deductibility of this class of expenditure is no longer specifically prohibited by regulation when claimed under Section 23(a)(1)(A) and it is undoubtedly ordinary and necessary, it need only be shown that it is consistent with public policy as that term has been defined for tax purposes in the *Lilly* case.

The petitioner's conduct, even if held to be the equivalent of lobbying, was honorable and without any taint of illegality or moral wrongdoing. There is abundant authority for the allowance of deductions even where both flagrant illegality and immorality are the cause of the expenditure. *Com'r* v. *Heininger,* 320 U. S. 467 (1943); *Helvering* v.

Hampton, 79 F. (2d) 358 (C. C. A. 9, 1935). This Court should not sanction the purely arbitrary and unfair discrimination of the respondent against the class of expenditures involved in this case. With the amendment of the specific regulation which provided the basis of decision in the *Textile Mills* case, the last obstacle to the abolition of an anachronistic rule has been removed. No sensible argument exists for its perpetuation. Properly carried on, legislative representation of businessmen is a necessary and desirable activity in this day of ever-increasing contact between government and business. This petitioner does not present the case for the briber, the influence peddler and their ilk. Since the *Textile Mills* decision the Congress which is properly most concerned with the lobbying problem has passed effective legislation to control and regulate it. In the Federal Regulation of Lobbying Act (2 U. S. C. A. §§ 261-270) enacted August 2, 1946 the Congress provided for the registration of lobbyists. The Report to the Senate of the "Special Committee on the Organization of Congress" on this Act describes the various types of lobbyists to which the registration requirement applies:

> "There is a third class of * * * respectable representatives of business, professional and philanthropic organizations who come to Washington openly and frankly to express their views for or against legislation, many of whom serve a useful and perfectly legitimate purpose in expressing the views and interpretation of their employers with respect to legislation which concerns them * * *." (S. Rept. 1400, 79th Cong., 2d Sess., p. 27)

A spokesman for the Committee presenting the bill on the floor of the House stated:

> "After all, government having moved so deeply into the whole business, economic and social field that the many fine organizations which represent various economic interests would be almost remiss in their obliga-

tion if they failed to keep abreast of developments in the legislative field." (Cong. Rec., Vol. 92, Part 8, p. 10090)

It could hardly be said that such activity belongs to the "family of contracts to which the law has given no sanction."[4] The very requirement of registration implies not only sanction, but conditional approval.

Petitioner does not claim that there is no remaining check on the expenditure of sums for lobbying purposes. The decision of this Court in the *Lilly* case provides a clear and workable test for the disallowance of expenditures, which although made in the ordinary course of business, are made for a purpose so repugnant to a federal or state policy that in good conscience they should not be deductible. It is submitted that this is the rule that would have been adopted by this Court in the *Textile Mills* case but for the existing regulation. In that case the taxpayer was employed on a contingent fee basis for the purpose of procuring private legislation to effect the return of property to the taxpayer's client under the Trading with the Enemy Act, the very type of arrangement condemned under the common law of contracts.

Justice Douglas, speaking for the Court, stated:

> "Contracts to spread such insidious influences through legislative halls have long been condemned. * * * There is no reason why, in the absence of clear Congressional action to the contrary, the rule-making authority cannot employ that general policy in drawing a line between legitimate business expenses and those arising from that family of contracts to which the law has given no sanction."

But we are faced here with an entirely different situation —the contribution was made to a national organization seeking by open and forthright means in the best tradition of American democracy to obtain a change in a public law

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[4] *Textile Mills Securities Corp.* v. *Commissioner*, 314 U.S. 326.

for what it believed was the public good. This was no clandestine activity replete with the trappings of secrecy, graft, and corruption. On the record in this case, it could hardly be found that the NTEA or the Petitioner was spreading "insidious influences" in the legislative halls or that the petitioner's contribution was an expense arising from that family of contracts to which the law gives no sanction. Certainly the Congress does not view it in this light as shown by the legislative history of the Lobbying Act quoted above.

Accordingly, stripped of the specific regulation governing the *Textile Mills* case, and without compensating support from the amended regulation or the statute, the respondent can only rely on the "pubic policy" doctrine to sustain his current position and that doctrine, as delineated in the *Lilly* case, gives no support to the respondent's position.

Petitioner sincerely belives that there is no longer any reason or justification for the rule urged by the Respondent which, without any legislative sanction, penalizes a type of activity which can play such an important and honorable role in the function of our government and in the enlightenment of our legislative representatives. Without overruling any of its previous decisions, this Court may approve the rule urged by the Petitioner, and still provide an effective bar to the deduction of expenses incurred in improper kinds of lobbying activities. *Lilly* v. *Com'r., supra.* Petitioner believes that a vital issue is squarely presented in this case which this Court should decide.

Conclusion

For the foregoing reasons, it is respectfully submitted that this petition for a writ of certiorari should be granted.

JOSEPH J. O'CONNELL, JR.,
Counsel for the Petitioner.

APPENDIX

Section 101(6), Internal Revenue Code:

"SEC. 101. EXEMPTIONS FROM TAX ON CORPORATIONS.

"Except as provided in paragraph (12)(B) and in supplement U, the following organizations shall be exempt from taxation under this chapter—

* * *

"(6) Corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, and no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation. * * *"

Section 101(7), Internal Revenue Code:

"(7) Business leagues, chambers of commerce, real-estate boards, or boards of trade, not organized for profit and no part of the net earnings of which inures to the benefit of any private shareholder or individual;"

Treasury Regulation 74, Article 262:

"Corporations are not entitled to deduct from gross income contributions or gifts which individuals may deduct under section 23(n). Donations made by a corporation for purposes connected with the operation of its business, however, when limited to charitable institutions, hospitals, or educational institutions conducted for the benefit of its employees or their dependents are a proper deduction as ordinary and necessary expenses. Donations which legitimately represent a consideration for a benefit flowing directly to the corporation as an incident of its business are allowable deductions from gross income. For example, a street railway corporation may donate a sum of money to an organization intending to hold a convention in the city in which it

operates, with the reasonable expectation that the holding of such convention will augment its income through a greater number of people using the cars. Sums of money expended for lobbying purposes, the promotion or defeat of legislation, the exploitation of propaganda, including advertising other than trade advertising, and contributions for campaign expenses, are not deductible from gross income."

Treasury Regulation 111, Section 29.23(a)-13:

"Corporate contributions.—No deduction is allowable under section 23(a) for a contribution or gift by a corporation if any part thereof is deductible under section 23(q). Thus, for example, if a corporation makes a contribution of $5,000, only $4,000 of which is deductible under section 23(q) (whether because of the 5 per cent limitation or requirement of actual payment, or both), no deduction is allowable under section 23(a) for the remaining $1,000.

"The limitations provided in section 23(a)(1) and this section apply only to payments which are in fact contributions or gifts to organizations described in section 23(q). For example, payments by a street railway corporation to a local hospital (which is a charitable organization within the meaning of section 23(q)) in consideration of a binding obligation on the part of the hospital to provide hospital services and facilities for the corporation's employees are not contributions or gifts within the meaning of section 23(q) and may be deductible under section 23(a) if the requirements of that section are otherwise satisfied. Donations to organizations other than those described in section 23(q) which bear a direct relationship to the corporation's business and are made with a reasonable expectation of a financial return commensurate with the amount of the donation may constitute allowable deductions as business expenses. For example, a street railway corporation may donate a sum of money to an organization (of a class not referred to in section 23(q)) intending to hold a convention in the city in which it operates, with

a reasonable expectation that the holding of such convention will augment its income through a greater number of people using its cars."

Treasury Regulation 111, Section 29.23(q)-1:

"Contributions or gifts by corporations.—A corporation may, subject to the limitations provided by section 23(q), deduct from its gross income contributions or gifts to organizations described in section 23(q), except in computing net income for taxable years beginning before January 1, 1944, contributions or gifts to organizations organized and operated exclusively for veterans' rehabilitation services, or posts or organizations of war veterans, or auxiliary units of, or trusts or foundations for, any such posts or organizations are not deductible unless such contributions qualify as deductions under section 23(q) prior to its amendment by section 114 of the Revenue Act of 1943. See section 29.22(b)(4)-1 for definition of 'political subdivision.' Where payment is made in a taxable year beginning before January 1, 1949, the charitable deduction prescribed is allowable to corporations even though the gifts or contributions are used outside of the United States or its possessions. Such deduction shall, to the extent provided by that section, be allowed only for the taxable year in which such contributions or gifts are actually paid, regardless of when pledged and regardless of the method of accounting employed by the corporation in keeping its books and records. As to charitable contributions by corporations not deductible under section 23(a), see section 29.23(a)-13. Sums of money expended for lobbying purposes, the promotion or defeat of legislation, the exploitation of propaganda, including advertising other than trade advertising, and contributions for campaign expenses are not deductible from gross income. * * *"

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In the Supreme Court of the United States

OCTOBER TERM, 1952

No. 319

ROBERTS DAIRY COMPANY, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The findings of fact and opinion of the Tax Court (R. 28-35) are unreported. The opinion of the Court of Appeals (R. 106-111) is reported at 195 F. 2d 948.

JURISDICTION

The judgment of the Court of Appeals was entered April 15, 1952. (R. 111-112.) A petition for rehearing (R. 113-119) was denied on May 7, 1952 (R. 121). By an order made by Mr. Justice Clark on July 22, 1952, the time for filing a petition for a

writ of certiorari was extended to and including September 8, 1952. The petition for a writ of certiorari was filed September 6, 1952. The jurisdiction of this Court is invoked under 28 U.S.C., Section 1254.

QUESTION PRESENTED

Whether the Court of Appeals correctly affirmed the decision of the Tax Court that the $750 payment made by the taxpayer to the National Tax Equality Association was not deductible from gross income as an ordinary and necessary business expense under Section 23(a)(1)(A) of the Internal Revenue Code.

STATUTE AND REGULATIONS INVOLVED

The pertinent provisions of the Internal Revenue Code and of Treasury Regulations 111 are set forth in the Appendix, *infra*.

STATEMENT

This is a proceeding involving excess profits taxes, brought to the Tax Court (R. 3-22) by petitioner, Roberts Dairy Company (hereinafter referred to as the "taxpayer"), in which, after the elimination of other issues, the only issue submitted to the Tax Court for decision was whether the sum of $750 paid by the taxpayer to the National Tax Equality Association (hereinafter referred to as "NTEA") in 1943 was deductible from its gross income, either under Section 23(a)(1)(A) or Section 23(q)(2) of the Internal Revenue Code (R. 29).

The facts, as found by the Tax Court [1] (R. 29-31) and as recited in the opinion of the court below (R. 107-111), may be summarized as follows:

The taxpayer, whose principal place of business is in Omaha, Nebraska, is engaged in the dairy business as an "independent," buying its milk from producers. In 1943 and prior years, the taxpayer was faced with severe competition from "cooperative" dairies, and had difficulty retaining its suppliers and customers because of the advantages the cooperatives, largely as a result of their tax-exempt status under Section 101(12) and (13) of the Code, were able to offer. (R. 29.)

To meet that competition, the taxpayer had the alternatives of changing itself into a "cooperative"; of showing to its customers and suppliers, by facts and statistics, the tax advantages of the cooperatives and thereby explaining its competitive position; or of ultimately achieving in some way a tax status equal to that of the cooperatives. To obtain aid from the services proposed by NTEA in meeting these problems, the taxpayer in October of 1943 paid $750 to NTEA, and subsequently received the bulletins, research publications and other literature distributed by NTEA. (R. 29-30.)

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[1] The facts were developed by a stipulation between the parties (R. 37-38), exhibits attached thereto (R. 39-67), some oral testimony (R. 74-97), and additional exhibits adduced in evidence at the hearing (R. 95, 96). The latter exhibits, designated as Petitioner's Exhibit 6 and Respondent's Exhibits A through G, by order of the court below (R. 100-101) were not included in the printed record, but copies or reproductions thereof in their original form were supplied to the court below and have been filed in this Court.

NTEA, a non-profit organization supported by contributions from its members, had been organized "to conduct educational, scientific and research activities relative to disparities in federal and state tax statutes" and "to disseminate such information * * * to the public and to federal and state governments." (R. 30.) NTEA was organized and primarily operated from its inception for the dissemination of propaganda designed to bring about a revision in the tax structure. (R. 31.) [2]

In his determination, the Commissioner disallowed the deduction for the $750 contribution to NTEA claimed by the taxpayer on its return for 1943. (R. 9, 10, 11.)

The Tax Court, upholding the Commissioner's action, held that the payment of $750 made by the taxpayer to NTEA in 1943 was not deductible from gross income, either as an ordinary and necessary business expense or as a contribution, under Section 23(a)(1)(A) or 23(q)(2), respectively. (R. 31-35.) The court below affirmed. (R. 107-111.)

ARGUMENT

1. Section 29.23(q)-1 of Treasury Regulations 111 provides that—

> Sums of money expended for lobbying purposes, the promotion or defeat of legislation, the exploitation of propaganda, including advertising other than trade advertising, and

[2] Since this ultimate finding of fact by the Tax Court is not challenged before this Court (Pet. 5, 6), we omit from this statement a recital of any further evidentiary facts found by the Tax Court relative to NTEA (R. 30-31).

> contributions for campaign expenses are not deductible from gross income.

The identical provision of an earlier regulation, of long standing, has been upheld by this Court, and has been held applicable to deductions for expenditures claimed under Section 23(a) of the Code as ordinary and necessary business expenses. *Textile Mills Corp.* v. *Commissioner,* 314 U. S. 326.

The *Textile Mills* decision controls here. The Tax Court found (R. 31), and taxpayer accepts the finding (Pet. 6; cf. R. 70), that NTEA was organized and operated for the carrying on of propaganda seeking a revision of the tax laws. Accordingly, the Commissioner and the courts below were obviously correct in the view that taxpayer's payment to NTEA was not deductible as ordinary and necessary expenses under § 23(a), "since [it] clearly [runs] afoul of * * * the regulation." *Textile Mills, supra,* at 337.[3] There is no merit in the suggestion (Pet. 6-9, 12) that deductibility of the payment should be tested only "on the basis of the purposes and objectives of the taxpayer claiming the deduction," without regard to "the activities or purposes of the donee of the contribution" (Pet. 6). Both courts below have found (R. 34,

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[3] The taxpayer has abandoned here (cf. R. 32, 107) its argument that the contribution was deductible under Section 23(q)(2) of the Internal Revenue Code which expressly denies deductibility where a "substantial part of the activities of [the donee] is carrying on propaganda, or otherwise attempting, to influence legislation * * *."

110) that "the only reasonable purpose for the existence of NTEA [was] to influence legislation and contributions to it were used for that purpose." The attempt to evade the consequences of this finding by urging that the taxpayer's private purposes were different from those of the agency to which it gave its funds cannot alter or obscure the fact that the funds were "expended for * * * the promotion * * * of legislation * * * [and] the exploitation of propaganda * * * ."

The taxpayer not only fails to recognize that this case is governed by *Textile Mills,* but seeks (Pet. 9-10, 12-13) to show that the "decision of the Court of Appeals in affirming the Tax Court is a misconstruction of that decision and is necessarily in conflict with it" (Pet. 13). *Textile Mills,* the taxpayer argues, merely approved disallowance of a deduction where the sums are expended for "lobbying purposes" by a taxpayer in the "lobbying business." Even if this rigidly constricted reading of *Textile Mills* were warranted, there would be no basis for taxpayer's assertion of a "conflict." But it seems clear in addition that, in approving the validity of a regulation identical to the one in question and its applicability to the particular facts presented in *Textile Mills,* this Court made no such narrow distinction as the one taxpayer presses. Here, as there, the decisive fact is that the regulation, a clearly permissible interpretation of the statutory reference to "ordinary and necessary expenses", precludes the claimed deduction.

Even less substantial is the assertion (Pet. 6-7,

8, 9) that the courts below considered only Section 23(q)(2) and neither considered nor passed upon the argument that Section 23(a)(1)(A) authorized the deduction taxpayer sought. Both the Tax Court and the Court of Appeals unequivocally recognized (R. 29, 31-32, 107) that the taxpayer claimed the deduction alternatively, under either section. Both courts held that, on the facts of this case, Section 29.23(q)-1 of the Regulations (which applies to deductions claimed as business expenses under Section 23(a), *Textile Mills Corp.* v. *Commissioner, supra,* at 338) justified the disallowance of the deduction under either section.

2. The taxpayer argues (Pet. 13-17) that changes in the tax statutes and regulations since the *Textile Mills* decision require a different result here.[4] Since the taxable years involved in that case, the argument runs, Congress has specifically authorized deductions of charitable contributions by corporations, in what is now Section 23(q)(2) of the Code; the regulation involved in *Textile Mills* has been divided in two, and the presently relevant portion, Section 29.23(q)-1 of Regulations 111, applies only to deductions claimed for charitable contributions under Section 23(q)(2) of the Code; and, as a result of these changes, deductions for lobbying purposes claimed under Section 23(a)(1)(A) of the Code are "no longer specifically prohibited by regulation" (Pet. 17). But this is only a repetition of an argument made and briefly dis-

[4] This argument is made for the first time in this Court.

missed in the *Textile Mills* case where, applying the identical predecessor of the present regulation, this Court said the "argument that it was not applicable because it was not specifically incorporated under §23(a) is frivolous." 314 U.S. at 338. Phrased generally, the regulation says that sums like the one in dispute "are not deductible from gross income." The failure to repeat this restriction in regulations attached to every section under which such a deduction might be claimed is of no more weight here than it was in *Textile Mills.*

3. Finally, there is no merit in the contention (Pet. 17-20) that, in order to be non-deductible under Section 23(a)(1)(A), an expenditure must have been for something sinister, illegal, or profoundly repugnant to public policy. In support of this argument, taxpayer invokes the recent decision in *Lilly* v. *Commissioner,* 343 U.S. 90 (Pet. 19-20). There, however, as taxpayer acknowledges (Pet. 13), this Court emphasized that the decision in the *Textile Mills* case was distinguishable, turning on an interpretative regulation which "had itself been in effect many years with congressional acquiescence." 343 U.S. at 95. As we have shown, the instant case, unlike *Lilly,* comes "within that precedent." *Ibid.* The same regulation, enjoying still the acquiescence of Congress, has led to a similar result. The plain terms of the regulation have never been limited to preventing only deductions for illegal or shady purposes, and nothing in the *Lilly* case or any other indicates any reason why they should be so limited now. See *Bellingrath* v.

Commissioner, 46 B.T.A. 89; cf. *Sunset Scavenger Co.* v. *Commissioner,* 31 B.T.A. 758, 763, reversed, 84 F. 2d 453 (C.A. 9).

CONCLUSION

The decision below is correct. It turns upon the particular facts of the case and presents no question calling for further review by this Court. There is no conflict of decisions. The petition should, therefore, be denied.

Respectfully submitted,

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OCTOBER, 1952.

APPENDIX

Internal Revenue Code:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

(a) [as amended by Section 121 (a) of the Revenue Act of 1942, c. 619, 56 Stat. 798] *Expenses.*—

(1) *Trade or Business Expenses.*—

(A) *In General.*—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered; traveling expenses (including the entire amount expended for meals and lodging) while away from home in the pursuit of a trade or business; and rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity.

(B) *Corporate Charitable Contributions.*—No deduction shall be allowable under subparagraph (A) to a corporation for any contribution or gift which would be allowable as a deduction under subsection (q) were it not for the 5 per centum limitation therein contained and for the requirement therein

that payment must be made within the taxable year.

* * * * *

(q) [as amended by Section 1225 of the Revenue Act of 1942, *supra*] *Charittable and Other Contributions by Corporationss.*—In the case of a corporation, contributions or gifts payment of which is made within thee taxable year to or for the use of:

* * * * *

(2) A corporation, trust, or community chest, fund, or foundation, created or organized in the United States or in any possession thereof or under the law of the United States, or of any State or Territory, or off the District of Columbia, or of any possession of the United States, organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes or for the prevention of cruelty to children (but in the case of contributions or gifts to a trust, chest, fund, or foundation, payment of which is made within a taxable year beginning after the date of the cessation of hostilities in the present war, as proclaimed by the President, only if such contributions or gifts are to be used within the United States or any of its possessions exclusively for such purposes, no part of the net earnings of which inures to the benefit of any private shareholder or individual, and no substantial part of the activities of which is carrying on propa-

ganda, or otherwise attempting, to influence legislation;

to an amount which does not exceed 5 per centum of the taxpayer's net income as computed without the benefits of this subsection. Such contributions or gifts shall be allowance as deductions only if verified under rules and regulations prescribed by the Commissioner, with the approval of the Secretary.

* * * * *

(26 U.S.C. 1946 ed., Sec. 23.)

Treasury Regulations 111, promulgated under the Internal Revenue Code:

Sec. 29.23(a)-13. *Corporate Contributions.* No deduction is allowable under section 23 (a) for a contribution or gift by a corporation if any part thereof is deductible under section 23(q). Thus, for example, if a corporation makes a contribution of $5,000, only $4,000 of which is deductible under section 23(q) (whether because of the 5 percent limitation or requirement of actual payment, or both), no deduction is allowable under section 23(a) for the remaining $1,000.

The limitations provided in section 23(a)(1) and this section apply only to payments which are in fact contributions or gifts to organizations described in section 23(q). For example, payments by a street railway corporation to a local hospital (which is a charitable organization within the meaning of section 23(q) in consideration of a binding obliga-

tion on the part of the hospital to provide hospital services and facilities for the corporation's employees are not contributions or gifts within the meaning of section 23(q) and may be deductible under section 23(a) if the requirements of that section are otherwise satisfied. Donations to organizations other than those described in section 23(q) which bear a direct relationship to the corporation's business and are made with a reasonable expectation of a financial return commensurate with the amount of the donation may constitute allowable deductions are business expenses. For example, a street railway corporation may donate a sum of money to an organization (of a class not referred to in section 23(q)) intending to hold a convention in the city in which it operates, with a reasonable expectation that the holding of such convention will augment its income through a greater number of people using its cars.

* * * * *

Sec. 29.23(q)-1. *Contributions or Gifts by Corporations.*—A corporation may deduct from its gross income contributions or gifts to organizations described in section 23(q) (see section 29.22(b)(4)-1 for definition of "political subdivision") * * * Such deduction shall, to the extent provided by that section, be allowed only for the taxable year in which such contributions or gifts are actually paid, regardless of when pledged and regardless of the method of accounting employed by the corpo-

ration in keeping its books and records. As to charitable contributions by corporations not deductible under section 23(a), see section 29.23 (a)-13. Sums of money expended for lobbying purposes, the promotion or defeat of legislation, the exploitation of propaganda, including advertising other than trade advertising, and contributions for campaign expenses are not deductible from gross income.

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